December 28, 2001

The Honorable Board of Supervisors
County of San Diego
San Diego County Administration Center
San Diego, California 92101

The annual financial report of the County of San Diego for the fiscal year ended June 30, 2001, has been prepared by the Chief Financial Officer/Auditor and Controller and is submitted in compliance with Section 25253 of the Government Code of the State of California. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with County staff. The report has been prepared in accordance with generally accepted accounting principles and is organized into three major sections. The introductory section consists of this letter and the organizational structure of the County. The financial section provides the financial statements for the fund types and account groups of the County. Within this section, the general purpose statements and notes thereto for all fund types and account groups are presented first, followed by statements and schedules for individual fund types and account groups. The statistical section is the final section of the report and consists of various tables and schedules depicting trends and miscellaneous relevant data concerning County finances and demographics.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2000. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such a report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA.

The general purpose financial statements include the activities of the various fund types and account groups of the County and certain other entities for which the Board of Supervisors are financially accountable as defined by the Governmental Accounting Standards Board. Accordingly, all fund types and account groups of the County are reported herein as well as the operations of the following entities:

County Service Districts
Flood Control District
Lighting Maintenance District
Air Pollution Control District
County of San Diego Housing Authority
Sanitation Districts
San Diego County Redevelopment Agency
San Diego County Capital Asset Leasing Corporation (SANCAL)
San Diego County Employees Retirement Association (SDCERA)
San Diego County Children and Families Commission (SDCCFC)

GOVERNMENTAL STRUCTURE, LOCAL ECONOMIC CONDITION AND OUTLOOK

The County was incorporated on February 18, 1850, and functions under a Charter adopted in 1933, as subsequently amended. A five-member Board of Supervisors elected to four-year terms in district nonpartisan elections governs the County. There are 18 incorporated cities in the County and a large number of unincorporated communities. The County provides a full range of public services including public assistance, judicial, police protection, detention and correction, health and sanitation, recreation and others.

The San Diego Economic Research Bureau forecasted that San Diego's economy would climb slower, but nonetheless continued rising in 2001. The gross regional product (GRP), the value of all goods and services produced within the County, is forecast to reach $120.5 billion in 2001, another record for total economic production. San Diego's transition in the past from primary reliance upon defense expenditures to a diversified mix of technology-driven commercial industries gives the region greater economic strength, but also makes the region much more enmeshed with the rest of the U. S. and aligned with national and international economic trends. Because of the strength and diversity of San Diego's industries, association to Tijuana and Baja California, Mexico and the strong employment base, the region continued to exhibit stronger economic performance than the rest of the nation and state in 2001. San Diego County's population is expected to reach the 3.0 million mark sometime during 2001. The forecasts for 2002 anticipate an additional 38,000 County residents. This compares to a gain of 42,000 in 2001. Employment for 2001 and 2002 is expected to rise 1.9 and 1.4 percent respectively, compared to a rise of 3.5 percent in 2000. The unemployment rate is expected to increase slightly from an annual rate of 3.0 percent in 2000 to a rate of 3.1 percent in 2001. Per the County Assessor, property tax valuation in fiscal year 2001/02 increased 9.4% from fiscal year 2000/01.

During the fall of 2001, the state and local economies slowed considerably. The County's biggest sources of general purpose revenues are property taxes and vehicle license fees. Combined, they represent 84 percent of the total $568 million of general purpose revenues that are estimated to be received in fiscal year 2001/02. Neither revenue is immediately impacted by a downturn in the economy. Sales tax, approximately 3 percent of total general purpose revenues, is more sensitive to a slowdown, but there is about a six-month lag time after a change in direction occurs. Of particular concern at this time is the health of the State's economy and budget. Reports from the State indicate that it may have as much as a $4.5 billion budget problem this fiscal year due to lagging revenue from a slumping economy. The State's general fund budget for fiscal year 2001/02 is heavily dependent on personal income tax, sales tax and bank and corporation taxes to finance services, all of which are extremely vulnerable in a faltering economy. State revenues make up 23.5 percent of the County's overall program revenues.

The economy, the State's budget situation, a potential economic stimulus package as well as the increased cost of bio-terrorism prevention have caused the County to take a proactive approach by reviewing all State-funded programs and developing strategies to protect critical services and local revenues.

MAJOR INITIATIVES

On the financial front, the County maintained a structurally balanced budget, using one-time resources for one-time costs and ongoing revenues for ongoing expenses. The value of this approach was proven when the County was able to absorb dramatically higher utility costs caused by the State's higher energy crisis without cutting services. The County's future fiscal stability will also be enhanced by the historic, five-year labor agreements reached with most of its employee unions. In addition, the County intends to secure funding for future health programs by selling approximately $466 million in tobacco securitization bonds. This innovative financing, endorsed by the San Diego County Taxpayers Association, will give the County the ability to better plan for the future.

One of the top priorities of the County is the strengthening of the County's "safety net" of health and human services. In this endeavor, the County Medical Services program was restructured to improve healthcare for indigent residents. As a result, the County was able to exceed its goal of enrolling 50,000 previously uninsured children into health insurance programs. In addition, the County not only increased the number of available foster homes by 13 percent, but opened the San Pasqual Academy, a residential education campus that offers a stable and nurturing environment for foster teens. Corporate and private donations have raised more than one-third of the money needed to pay for the $24 million project. The Welfare-to-Work Program has also been a major accomplishment. Through committed partnerships with private business and community agencies, the program continues to achieve successes. The reduction in welfare cases in San Diego County has far exceeded other California counties. Statistics for January 1995 through September 2000 show the County's caseload dropping 58 percent, while the rest of the state dropped 41 percent. For this innovative program, in 2001, the County earned a "Grand Watchdog" award from the San Diego County Taxpayers Association.

The County received national recognition from drug treatment and addiction experts for its plans to implement the Substance Abuse and Crime Prevention Act (Proposition 36), which mandates treatment instead of jail time for first and second time nonviolent offenders. Officials estimate some 6,000 people a year will need treatment under Proposition 36.

In an effort to improve its technology, the County continues to work on its Enterprise Resource Planning (ERP) financial systems. These systems include solutions to replace obsolete computer applications, improve customer service, and enhance efficiency. In addition, the County's data and phone network was completely replaced with a state-of-the-art fiber optic network. The new phone system included more than 21,000 new telephone handsets, and more than 5,000 personal computers were installed.

Through its environmental efforts, the County negotiated three unprecedented cooperative agreements with local Native American tribes, and $14.6 million was obtained for road improvements to mitigate casino traffic impacts. Also, the County obtained $63 million toward the Multiple Species Conservation Plan and Open Space Preserve programs. In addition, the County completed the strategic plan for Project Clean Water on time and with input and support from more than 78 agencies.

Over the past three years, strong state and local economies have allowed the County to enhance and add new programs and construct and improve facilities. The slowing economy and deteriorating State budget will require diligent oversight and prioritization of needs to ensure core program objectives in the face of potentially severe revenue shortfalls.

FINANCIAL INFORMATION

Accounting System and Budgetary Controls

The County of San Diego maintains its principal fund accounting records using a modified accrual basis of accounting, as explained in the Notes to Financial Statements, and follows the accounting practices for governmental units which have been recommended by the Governmental Accounting Standards Board.

Using the County's automated accounting system, the Chief Financial Officer/Auditor and Controller restricts each department's expenditures at the object level per State law to the amount of that department's budgeted appropriations for the year. Changes in appropriations must be approved by the Board of Supervisors as a transfer from contingency reserve, transfer from another budgeted unit, or as an appropriation of unanticipated or overrealized revenue identified to a specific source. No budget unit is permitted to spend more than its available appropriations. Any appropriations remaining at the end of the fiscal year, which have not been specifically committed, automatically lapse to the unreserved fund balance. This fund balance together with projected revenues become available for appropriation the following year.

Internal Accounting Controls

The Chief Financial Officer/Auditor and Controller is charged with maintaining adequate systems of internal control sufficient to ensure reliability and validity of financial reporting in accordance with generally accepted accounting principles and general law. This is accomplished through the application of a series of automated accounting controls and administrative procedures designed to ensure the integrity of County transactions and to safeguard County assets. This internal control structure is subject to periodic evaluation by both the internal audit staff of the County and the independent auditors. Accordingly, the Chief Financial Officer/Auditor and Controller represents that the current systems of internal control adequately safeguard County assets and provide reasonable assurance over the fairness of presentation of this report.

General Government Functions

The following schedules present a summary of revenues and other financing sources and a summary of expenditures and other financing uses for the County's General, Special Revenue, Debt Service, and Capital Projects funds. Amounts are stated in millions of dollars.

SUMMARY OF REVENUES AND OTHER FINANCING SOURCES:

	YEAR ENDED JUNE 30				PERCENT INCREASE (DECREASE)
	2001		2000		2001
	AMOUNT	PERCENT	AMOUNT	PERCENT	OVER 2000
Taxes	$ 432.5	13.2	$ 344.4	13.2	25.6
Licenses, Permits and Franchises	34.8	1.1	31.8	1.2	9.4
Fines, Forfeitures and Penalties	40.1	1.2	36.2	1.4	10.8
Use of Money and Property	74.2	2.3	48.5	1.8	53.0
Aid From Other Governmental Agencies:					
State	1,202.1	36.8	1,070.5	41.0	12.3
Federal	489.0	15.0	455.0	17.4	7.5
Other	48.1	1.5	49.6	1.9	(3.0)
Charges for Current Services	223.3	6.8	209.4	8.0	6.6
Other Revenues	37.2	1.1	28.8	1.1	29.2
TOTAL REVENUES	2,581.3	79.0	2,274.2	87.0	13.5
Sale of Fixed Assets	2.9	0.1	1.3	0.1	123.1
Long-Term Debt Proceeds	3.6	0.1	70.4	2.7	(95.0)
Issuance of Lease Purchases			1.7	0.1	(100.0)
Operating Transfers In	661.9	20.3	250.1	9.6	164.7
Proceeds of Refunding Bonds	18.4	0.5	15.0	0.5	22.7
TOTAL	$3,268.1	100.0	$2,612.7	100.0	25.1

SUMMARY OF EXPENDITURES AND OTHER FINANCING USES:

	YEAR ENDED JUNE 30				PERCENT INCREASE (DECREASE)
	2001		2000		2001
	AMOUNT	PERCENT	AMOUNT	PERCENT	OVER 2000
General Government	$ 136.7	4.5	$ 150.9	6.1	(9.4)
Public Protection	728.2	23.7	667.6	26.9	9.1
Public Ways and Facilities	83.9	2.7	72.7	2.9	15.4
Health and Sanitation	454.6	14.8	370.4	15.0	22.8
Public Assistance	747.5	24.4	737.3	29.7	1.4
Education	18.6	0.6	14.3	0.6	30.1
Recreation and Cultural	13.1	0.4	12.4	0.5	5.6
Capital Outlay	57.7	1.9	55.2	2.2	4.5
Debt Service	140.0	4.6	110.2	4.4	27.0
TOTAL EXPENDITURES	2,380.3	77.6	2,191.0	88.3	8.6
Operating Transfers Out	661.2	21.6	258.0	10.4	156.3
Payments to Refunded Bond Escrow Agents	18.4	0.6	15.0	0.6	22.7
Residual Equity Transfers Out	7.1	0.2	16.2	0.7	(56.2)
TOTAL	$ 3,067.0	100.0	$ 2,480.2	100.0	23.7

Revenues for general County functions increased by approximately $307 million over the prior year with $131 million attributed to changes in accounting methods in reporting revenues. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 33, revenues from all nonexchange transactions are being recognized when funds are earned. In prior years, those funds were included in the Trust and Agency Fund section of the financial statements. As such, funds received were not reported in the general County functions of the financial statements. The remaining $176 million is mostly attributed to increases in State and Federal revenues. The most significant increases were experienced in

Public Safety Augmentation funds ($22 million), State Tobacco Tax settlement ($16), and Vehicle License fees and State Sales Tax Realignment revenues ($22 million).

Other significant increases are reflected in the tax category which increased by approximately $88 million from the previous year. Revenue from Proposition 10 (Tobacco Tax revenue) accounted for approximately $48 million of the increase. This is a fairly new funding source and is now being reported as a County Special Revenue fund. The remaining increase was generated by property taxes due to increases in assessed valuation and resales of existing homes.

Operating Transfers In and Operating Transfers Out increased by approximately $412 million from the previous year. Approximately $358 million of this amount is attributed to the accounting method changes mentioned above. The County established Special Revenue funds for the Safety Augmentation Sales Tax (Proposition 172), Health and Social Services' Realignment monies, and the ongoing Tobacco Tax (Proposition 10) receipts. Revenues are recognized in the Special Revenue funds and treated as operating transfers when moved to the General Fund (or other funds) to reimburse expenses incurred. Other significant increases of approximately $27 million include the prepayment and first time payments of new long-term debt.

Total expenditures increased by approximately $189 million over the prior year. The largest single increase was due to labor costs for new positions and negotiated salary increases. Total labor costs increased by approximately $95 million. Within County functions, Health and Public Assistance as well as Public Protection continue to experience the greatest increases in expenditures with respective increases of $94 and $61 million. General Government functions declined by approximately $14 million. This was largely attributed to the shifting of Information Technology services from a General Fund department to an Internal Service Fund. The increases in expenditures were supported by the substantial increase in State and Federal revenues and higher general-purpose revenues. General Fund unreserved fund balance amounted to approximately $351 million at June 30, 2001. This represents an increase of $105 million from the previous year. The change in accounting method mentioned above caused $63 million of the increase. This change also required the County to report as a County General Fund function funds that were previously reported in the Trust and Agency Fund section of the financial statement. This $63 million has been, by various Board of Supervisors' directives, designated for specific programs. The remaining $42 million increase was generated by a greater than anticipated increase in general fund revenues.

Results Of Operations - Enterprise Funds

During fiscal year 2000/01, these funds received total revenue, capital contributions and net operating transfers of $38.9 million and incurred expenses of $36.4 million resulting in net income of $2.5 million. At June 30, 2001, these funds had a $98.6 million balance in retained earnings. The major share of this balance included $78.2 million in 6 sanitation districts and $20.0 million in the Airport Enterprise Fund.

Results Of Operations - Pension Trust Fund

Contributions to the Pension Trust Fund for fiscal year 2000/01 totaled $52 million, while Fund investments experienced a loss of $345 million due to the faltering stock market. In addition, after paying retirement benefits and investment expenses of $163 million, net assets decreased by $456 million over the previous fiscal year. The total net assets held in trust for pension benefits as of June 30, 2001 was $3.82 billion.

Debt Administration

The County has no outstanding general obligation or revenue bonds, although in accordance with generally accepted accounting principles, in particular Governmental Accounting Standards Board Statement No. 14, the County's "reporting entity" as reflected in this financial report has the following outstanding bonded debt:

Proprietary Fund Revenue Bonds	$	25,000
Pension Obligation Bonds		317,345,000
Redevelopment Agency Revenue Bonds		4,770,000
Certificates of Participation (COP)		466,450,000
Total	$	788,590,000

Proprietary Fund Revenue Bonds are legal obligations of a sanitation district. The Pension Obligation Bonds represent obligations of the County to fund the prior years' unfunded actuarial accrued liability of the SDCERA pension trust fund. The Redevelopment Agency Revenue Bonds are obligations to finance the Agency's capital improvements, while the COP are legal obligations of a non-profit corporation formed for the sole purpose of financing the acquisition or construction of County facilities. Interest expense to maturity on bonded debt is projected at $265.8 million. Short-term financings consisted of Tax and Revenue Anticipation Notes (TRANS) for $175.0 million and an outstanding balance of $63.9 million in short-term Teeter Obligation Commercial Paper Notes. The Teeter Obligation notes are secured by future collections of delinquent property taxes and were used to provide various taxing agencies the amount of their property taxes without regard to such delinquencies.

Credit Ratings

Moody's upgraded credit ratings for the County's long-term COPs and Pension Obligation Bonds during fiscal year 1999-2000 to A1 and Aa3 respectively. The Pension Obligation Bonds were upgraded by Standard and Poors to AA-. During fiscal year 2000/01, Standard and Poors upgraded the credit rating for the County's long-term COPs to AA- and gave the highest possible rating to the County investment pool. Short-term Tax and Revenue Anticipation Notes continued to receive the highest ratings from both Moody's and Standard and Poors.

SANCAL

On June 28, 2001, SANCAL issued $18.4 million in Certificates of Participation (COP) with a variable interest rate. This variable-rate debt does not have minimum and maximum rate limits. At the pricing date, the assumed variable interest rate was 4%. The net proceeds will be used to refund $38.1 million of COP issued by SANCAL in 1991 for the Interim Justice Facility Project. The COP issued by the Corporation were secured by long-term capital leases between the County and the Corporation. The net proceeds of $17.9 million (less underwriting fees of $184,000 and other issuance costs of $347,000) were used to purchase the par value of $18.4 million in U.S. Government securities and to fund certain reserves for the COP. Those securities were deposited in an irrevocable trust with an escrow agent to provide for the payment of the outstanding securities. As a result, the SANCAL 1991 COP is considered defeased. The liability for those COP issued by SANCAL and the long-term capital leases between the County and the Corporation have been removed from the General Long-Term Debt Account Group.

While there are inherent risks in issuing COP with variable rates, SANCAL will monitor the fluctuations in interest rates and will evaluate the economic advantage of refunding the issuance with a fixed rate or paying off the debt. Using the assumed variable rate of 4% at the time of pricing, SANCAL refunded the 1991 COP to achieve short-term budgetary savings to the County, to reduce the total debt service payments over the next 7 years by an estimated amount of $512,000, and to obtain an economic gain (difference between the present values on the old and new debt) by an estimated amount of $377,000. This SANCAL issue is reflected in the outstanding bonded debt amount shown above.

Certain buildings and equipment are being acquired under various capital leases (lease-purchases). Excluding those leases represented by the COP noted above, the outstanding obligation for these leases at June 30, 2001, totaled $76.5 million. Assuming all capital leases are held to full term, the total projected interest expense would be an additional $39.0 million.

Cash Management

Under a pooled-money concept, the County invests all idle cash in various securities with maturities planned to coincide with projected needs while attempting to maximize yield. The portfolio during the year was as follows: Government Securities, 38%; Commercial paper, 33%; Repurchase Agreements, 11%; Negotiable Certificates of Deposit, 7%; Mutual Funds, 6%; Medium Term Notes, 4%; Bank Notes, 1%. Time deposits in various depositories were fully collateralized in accordance with State statutes. These statutes require depositories having public funds on deposit to maintain a pool of securities with the agent of the depository having a market value of at least 10% in excess of the total amount of all public funds on deposit.

The weighted average yield of the Pool increased from 5.68% for the year ended June 30, 2000 to 6.37% for the year ended June 30, 2001.

Risk Management

The County purchases insurance for property damage, certain casualty claims, public-officials bond, employee dishonesty, faithful performance bond and loss of money for selected site locations. The County pays the deductible amounts that vary with each type of insurance. Effective, July 1, 2000 the County purchased workers' compensation excess insurance coverage for resulting claims of $1 -$5 million. In other words, the county is self-insured for individual workers' compensation claims of up to $1 million; insurance covers individual claims between $1 million and $5 million; and the County is self-insured for claims exceeding $5 million. The County is also self-insured for the following: claims arising from medical facilities, medical malpractice, errors and omissions, false arrest, forgery, and general liability.

The County's uninsured risk management activities are accounted for in an Internal Service Fund (ISF). During fiscal year 2000/01, fund equity increased $6.2 million in the Public Liability Insurance ISF while fund equity for the Workers' Compensation Fund decreased by $20.9 million. The decrease of fund equity in the Workers' Compensation Fund was due to a $25 million increase in the amount of the liability recorded for unpaid claims. The amount recorded was based on actuarial reviews conducted in 2001. Of the $25 million increase, $16 million was due to an increase in the minimum required level, and the additional $9 million increase was due to the County adopting a potential claims projection at an 80% confidence level. There was no change in the Public Liability Fund for unpaid claims as the amounts recorded were based on a 2000 actuarial study. Funding these liabilities has remained a County priority in order to achieve a planned fully reserved status.

While the above estimated liabilities were recorded based on actuarial studies, at June 30, 2001, County Counsel had 27 pending legal action cases with a probable and potential gross liability of $19 million, which could result if unfavorable adjudication were rendered. The range of litigation cases is from $100,000 to $5.4 million.

OTHER INFORMATION

Independent Audit

An independent auditors' report on the general purpose financial statements and combining and individual fund financial statements and schedules by the independent certified public accounting firm of KPMG LLP is included in the financial section of this report.

Acknowledgment

The preparation of the Comprehensive Annual Financial Report can only be accomplished through the dedicated and coordinated efforts of the accounting staffs of County departments and the staff of the Chief Financial Officer/Auditor and Controller. I applaud their contribution to ensuring that this report meets the highest reporting standards. I would also like to thank the members of the Board of Supervisors, the Chief Administrative Officer, Group/Agency General Managers and their staffs for their continued emphasis on conducting the financial operations of the County in accordance with sound business practices to achieve planned objectives.

Respectfully,

WILLIAM J. KELLY
Chief Financial Officer

Certificate of Achievement for Excellence in Financial Reporting

Presented to

County of San Diego, California

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2000

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director